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In the

Supreme Court of the United States

No. 48.

October Term, 1936.

TENNESSEE PUBLISHING COMPANY,
PETITIONER,

vs.

AMERICAN NATIONAL BANK, C. O. CARPENTER,
RECEIVER, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

REPLY BRIEF AND ARGUMENT ON BEHALF OF AMERICAN NATIONAL BANK, AND OTHER BONDHOLDERS AND CREDITORS.

May It Please the Court:

PRELIMINARY STATEMENT.

This cause involves a reorganization petition under Section 77B of the Bankruptcy Act, filed in the name of Tenness Publishing Company, a corporation, by E. W. Carmack, the owner of all of its common stock. The Tennessee Publishing Company was engaged in the publication of a morning and afternoon daily newspaper at Nashville, Ten-

nessee. Because of its insolvency its affairs had been practically fully administered in an equity proceeding in the United States District Court for the Middle District of Tennessee, under the management of a receiver appointed at the instance of bondholders and other creditors. The day before an order of sale was to be made in the orderly proceeding of the equity receivership cause, E. W. Carmack acquired all of the common stock of the debtor corporation (which was described by the District Judge as "notoriously insolvent") for an undisclosed consideration, and on the following day filed a petition for reorganization, based upon a desire to get control of the newspapers and with the hope of reaping a speculative profit, in furtherance of which the record now discloses that Carmack has disposed of a substantial portion of the common stock contingent upon his ability to have the Court approve his speculative venture. These are not mere *contention* or *conclusions*—they are admitted facts, as will be shown from the record.

The debtor's petition was filed on June 6, 1935. The cause remained before the District Judge slightly over four months, during which time Carmack, acting in the corporate debtor's name, filed a number of proposed plans for reorganization, the provisions of all of which were in such reckless disregard of the possibility of refinancing, and were so confused, involved and vague as to prompt the Circuit Court of Appeals to say:

> "We confess our inability to understand the debtor's proposed reorganization plan in all of its phases, even after diligent study, effort to separate argument from concrete proposals, and an earnest attempt to reconcile apparently conflicting clauses."
> (R., 155.)

Subsequently, in attempting to analyze certain provisions of the plan with respect to a proposed sale of bonds, the learned Circuit Court of Appeals, in its opinion, said:

> "We make no effort to state them, for they are wholly incomprehensible."
> (R., 156.)

No creditor, secured or unsecured, approved any of the plans. The entire proceedings, including all of the plans and amendments thereto, were affirmatively objected to and opposed by more than seventy-three per cent of the bondholders and more than fifty per cent of the unsecured creditors.

The debtor's proceeding was dismissed by the District Judge and the properties were ordered sold in the equity receivership. (R., 123.) His action was affirmed by the Circuit Court of Appeals for the Sixth Circuit (*In re Tennessee Publishing Company*, 81 F. (2d), 463). In the course of its opinion, in answer to the argument that the debtor was "sincere" in its efforts and therefore acting in "good faith," the Circuit Court of Appeals said:

> "It appears from the record that the total assets of the debtor upon fair appraisal are worth less than $300,000. The bonded indebtedness exceeds $900,000, and the unsecured indebtedness is more than $300,000. To this must now be added the cost and expenses of the receivership. Moreover, the receiver has been operating at a loss, and the debtor concedes that it also will for a time operate at a loss, its most optimistic undertaking being, if the property is restored to it, to reduce current losses 25%. When these figures are considered together with the vagueness of detail in the proposed plan, the doubt that exists as to whether under Section 77B there may now be a reopening of the adjudication of the claims against the debtor in the equity proceeding, it seems clear to us that the proposed plan is not a workable plan, offers no reasonable prospect for successful rehabilitation of the debtor, and is in consequence not, in the sense the phrase is used in the section, presented in good faith."
>
> (R., 157.)

The case now comes before this Court on a petition for *certiorari* filed May 4, 1936, and granted May 18, 1936.

STATEMENT OF THE CASE.

The General Creditors Suit.

The Tennessee Publishing Company is a corporation engaged in publishing two daily newspapers at Nashville, Tennessee, both being known as the *Tennessean*, one being published in the morning and the other in the afternoon. The essential facts with reference to the general creditors insolvency proceedings relating to this corporation prior to the filing of the debtor's petition in bankruptcy appear first in the answer and motion to dismiss filed by American National Bank, a creditor, on July 12, 1935. (R., 18-27.) In these proceedings the Tennessee Publishing Company will usually be referred to as debtor. The debtor issued its first mortgage bonds in the principal sum of $750,000.00 on November 1, 1928, secured by a deed of trust, duly registered, covering all of the properties of the debtor of every kind whatsoever excepting only certain fluctuating assets such as materials consumable in use, printing ink and newsprint paper, cash on hand and accounts receivable. The amount of principal and interest due and unpaid on these bonds as of July 1, 1935, was $879,375.00.
(R., 19.)

The various defaults averred in the general creditors bill existing at the time it was filed are not denied by the petitioners but are admitted. We quote from the petitioner's "Statement of the Case," as follows:

> "At the time of the filing of said bill in March, 1933, for the appointment of a receiver to conserve the assets of said corporation, its business was being neglected and its assets were being dissipated, under circumstances set out in said equity proceedings."
> Petition for *Certiorari*, p. 25(b).

The general creditors bill in equity was filed on March 3, 1933, and the "circumstances set out in said equity proceedings" referred to in the above quoted statement from the petition for *certiorari* were as follows:

(a) That debtor owed plaintiff approximately $100,000.-00, to secure which plaintiff held $28,000.00 of the aforementioned bonds along with certain other collateral, and said indebtedness was past due and unpaid.

(b) That the total liabilities of the debtor, including claims of all classes, were approximately $1,500,000.00 and the fair value of the debtor's physical assets was approximately $337,000.00, and that the debtor was hopelessly insolvent.

(c) That the debtor had operated continuously from the year 1929 to the filing of the bill at a tremendous loss, as follows:

1929 net operating loss	$ 18,779.79
1930 net operating loss	125,977.00
1931 net operating loss	133,900.34
1932 net operating loss	83,750.82

(d) That the affairs of the debtor had reached such a critical state that the total gross income from all sources was less than the operating expenses. The debtor was faced with additional monthly deficits and that it was unable to pay the salaries and wages due its employes, and had issued checks to its employes for salaries and wages which the bank had declined to pay because of insufficient funds.

(e) The debtor had no supply of newsprint paper other than that which it purchased daily from a local warehouse, and that the situation was so acute that the debtor would very shortly be unable to purchase the necessary newsprint paper in order to publish its daily morning and afternoon editions; that the debtor was delinquent in the payment of various taxes, and distress warrants had been issued and were in the hands of officers to be levied upon the debtor's assets; that the debtor had permitted its president, vice-president and general manager to withdraw large sums of money from its assets, and that the individals occupying these positions had recently been tried and convicted, and were then sentenced to serve a term in the penitentiary in the State of North Carolina; and that said individuals, who were the controlling spirits and owners of

the common stock of the debtor, had departed from their usual place of residence in Nashville, Davidson County, Tennessee, and had taken up residence in Montgomery County, Tennessee, and had to all practical purposes abandoned the affairs of the debtor corporation, which in the meantime had drifted into a hopeless financial condition with no hope of any financial rehabilitation from any source whatsoever, and its demise was only a matter of a few days.

(f) That the debtor during this period had permitted its machinery, equipment and presses to become in a bad state of repair, had failed to make the usual replacements required by the normal operations of the business, and was able to print its daily editions only with the greatest difficulties.

(g) That as a result of the foregoing situation and the neglect by the debtor of its corporate affairs, the circulation of the newspapers had dropped from 96,221 to 80,256, or a net loss in circulation over a two-year period of approximately 16,000.

(R., 20-21.)

Upon the filing of the bill the Honorable Lit J. Pardue was appointed as Receiver and took possession of debtor's properties on March 3, 1933, from and after which date he has had complete control of the operations and affairs of debtor, acting under the guidance and instruction of the court. On June 3, 1933, after notice and hearing and without any objection or protest on the part of the debtor, the court sustained the bill as a general creditors bill, and judicially declared the debtor to be insolvent and ordered a reference to the Standing Master to take proof and report upon the claims and priorities of all creditors, whose claims were required by notice and publication to be filed by December 15, 1933. Pursuant to this order claims aggregating approximately $1,500,000.00 were filed, including the claims of bondholders and various alleged unsecured creditors. (R., 21, 22.) Many of the claims were contested and hearings were had before the Standing Master over a period of several months, the testimony taken, excluding exhibits, comprising several hundred pages. Oral arguments were

had, brief's were filed, and on March 20, 1935, the Standing Master filed his report based upon all of the claims filed against the debtor. All of the bondholders appeared and proved their claims before the Standing Master, and no exception was filed to his report insofar as it related to the ownership and amount due on said bonds and the report of the Master became final as to these matters. (R., 22.) The owners and holders of the bonds were found and judicially determined, as follows:

Name	*Principal*
American National Bank, Nashville, Tenn.	$210,000.00
W. G. Bush & Company, Nashville, Tenn.	115,000.00
Canal Bank & Trust Company, New Orleans, La.	250,000.00
O. H. Ingram, Nashville, Tennessee	60,000.00
C. O. Carpenter, Receiver, Holston-Union National Bank, Knoxville, Tennessee	28,000.00
Broadway Discount Corporation, Nashville, Tennessee	23,000.00
Commerce-Union Bank, Nashville, Tenn	64,000.00

The District Judge, in dismissing the debtor's petition, referred to the foregoing facts in the following language:

> "In that case the validity and amount of the bonds outstanding was established. The debtor was a party to that suit; the question was submitted to the Standing Master; and he made his report covering that question. The report, I am informed, is unexcepted to."
> (R., 122.)

Certain exceptions were filed with respect to some of the unsecured claims and these exceptions were argued before the court and taken under consideration. Thereafter, by proper proceedings and on motion of the plaintiff in the equity receivership cause, a final hearing was ordered to be held on June 6, 1935, for the purpose of acting on the exceptions to the Master's report and to order a sale of the properties so as to terminate the receivership.
(R., 22, 23.)

The debtor corporation was a party to all of these proceedings and had notice of each step taken, and the debtor corporation stood by for an entire year and permitted the equity proceedings to be carried to the point of practically a complete liquidation without filing any proceedings for reorganization. It further appeared that the receivership during the calendar year 1933, notwithstanding the arduous attention and careful handling by the receiver, operated at a loss of approximately $10,000.00, not including interest on the bonds, and also that it operated at a loss for the year 1934 in approximately the same amount. The receiver owed for borrowed money $28,328.62, and had on deposit less than $1,000.00, the corporation having no working capital in the business.

(R., 24.)

The debtor's situation was described by the District Judge as follows:

> "It is admitted, and in fact, is abundantly shown by the report of the Standing Master in the equity cause, that the debtor is *notoriously insolvent.*"
>
> (R., 122.)

The facts leading up to the filing of the debtor's petition for reorganization, in the most favorable aspect to the petitioner, may be obtained from the original petition filed June 6, 1935, (R., 2-7), and the pleading entitled "Explanatory Petition of Debtor" filed October 14, 1935.

(R., 79.)

The original petition avers that the debtor has made default in the payment of its bonds aggregating $750,000.00, and the interest thereon, and that the corporation owes unsecured debts in an additional sum of $750,000.00, has $300,000.00 in preferred stocks outstanding, and that the court was about to order a sale of the properties in the equity proceeding. It further avers:

> "The debtor would show that of the total amount of the common capital stock outstanding 2995 shares belong to the president of the corporation, Edward W.

Carmack, the same being all of the common capital stock of the corporation except 5 shares."
(R., 4.)

The Circuit Court of Appeals found as a fact:

"On June 5, 1935, Carmack, son of a former editor of the debtor's papers, acquired from the Leas, then its owners, all of the debtor's common stock. He immediately had himself elected president, and instituted the debtor proceedings here involved under Section 77B."
(R., 152-153.)

The facts appearing from the "Explanatory Petition" of debtor are illuminating. E. W. Carmack's father, prior to his death 27 years before this proceeding was filed, had at one time been editor of the *Tennessean*. At the time of his death he owned 5% of the preferred stock, which was in the name of one Lander as trustee, and presumably since his death Edward W. Carmack, Jr.'s mother owned one-half and evidently Carmack, Jr., owned one-half of this stock, each having 2½% of the preferred stock.

Carmack states that about a year before the filing of the receivership bill he "began to devise plans to acquire a further interest in the properties of debtor corporation to the end that he might become editor-in-chief of the papers published by the debtor. . . ." (R., 80.) He states that he had "good reasons to believe that said papers could be made a *paying proposition* by proper and economical management." (R., 81.) His "fixed purpose was to become editor of the paper and establish it as a profitable business enterprise. . . ." (R., 81.) Luke Lea owned all of the common stock which controlled the newspaper. Carmack admits that he made no effort to purchase this common stock from Lea until the "spring of 1935"—only a month or so prior to the filing of the debtor's petition, more than two years after the receivership. He acquired this common stock from Luke Lea "immediately prior to the filing of the petition of June 6, 1935." (R., 81.) We quote from Carmack's own "Explanatory Petition:"

"On June 5, 1935, a meeting of the stockholders of debtor corporation was held, when Luke Lee, Jr., then the holder of the common stock of his father, Colonel Lea, in furtherance of the trade which had been made by said Carmack, voted his father's stock under a power of attorney authorizing him so to do, at which meeting E. W. Carmack, Jr., was elected President of debtor corporation. . . . (R., 81-82.)

"At the meeting of June 5, 1935, a Board of Directors was first elected by the stockholders present and this Board of Directors formally elected the officers of the corporation, including E. W. Carmack, Jr., President, and both in the meeting of the stockholders and in the meeting of the Directors, action was taken authorizing and directing the filing of the petition for the reorganization of debtor corporation which was sought by the petition filed on June 6, 1935." (R., 82.)

In answer to the bondholders' averment that Carmack had acquired this common stock knowing that it was worthless, as the corporation was hopelessly insolvent, and for purely speculative purposes and without consideration, the "Explanatory Petition" averred "debtor further states that E. W. Carmack, Jr., acquired the common stock of debtor corporation from Colonel Luke Lea for a valuable consideration *agreed upon* between E. W. Carmack and representatives of Colonel Luke Lea." (R., 82.) It was not claimed that any consideration had been *paid* but only that it had been agreed upon, and although Carmack felt called upon to file an explanatory petition he did not undertake to disclose what consideration, if any, was paid for this worthless stock.

This "explanatory petition" further discloses that since the filing of the original petition Carmack had sold and disposed of a substantial portion of the common stock. This sale was to parties having no previous connection with the Debtor corporation. We quote from the petition:

"That is to say, that by the arrangement above mentioned under which other persons now have a valid and subsisting interest in said common stock standing in the name of E. W. Carmack, Jr., under which arrange-

ment experienced and capable business men are to become actively connected with the operation of debtor corporation, as soon as the reorganization plan is approved by the Court, and are to furnish funds both for the purpose of complying with the orders of the Court in connection with the reorganization plan, and also funds sufficient adequately and properly to carry on the business of debtor corporation by the publication of a daily newspaper or newspaper in Nashville."
(R., 79-80.)

It appears therefore that this proceeding was not instituted by a corporation in the ordinary course of its affairs but that on the day before the final liquidation of a hopelessly insolvent corporation under a general equity proceeding, an individual for speculative purposes and in the sole hope of financial reward purchased and acquired the entire outstanding worthless common stock for an undisclosed and unpaid consideration, and resold a substantial portion to certain "financial interests" contingent upon this stockholder's ability to successfully defeat the orderly liquidation in the general equity receivership cause by the filing of this petition and acquiring the assets at an appraisal, notwithstanding the existence of a starting cash bid in the equity proceeding greatly exceeding the appraised value of the property. Apparently, this individual was to be rewarded with the editorship of the papers, carrying certain financial perquisites, and outside speculators and strangers to the debtor corporation were to own substantially all of the stock.

Proceedings Dismissed by District Judge on Original Show Cause Order.

The life of this proceeding began with the filing of the original petition for reorganization on June 6, 1935, and ended with the dismissal of the petition on October 25, 1935. At the time the original petition was filed the District Judge entered a decree permitting the petition to be filed upon the ground that its allegations complied with the requirements of the law, and adjudged *pro forma* that the petition was filed in good faith but issued an order for

creditors and other parties to appear on July 6, 1935, for the purpose of showing cause, if any, as to whether or not the petition should be dismissed. This order read:

> "It is further ordered, adjudged and decreed that a rule forthwith issue against all parties to the aforesaid Receivership case, and to all creditors and stockholders in the Tennessean Publishing Company to appear and show cause, if any, as to whether or not the aforesaid petition of the Tennessee Publishing Company should be dismissed at a hearing before the Judge of this court at the Federal Court Room, in Nashville, at 9:00 a.m. on July 6, 1935, and L. J. Pardue, Esq., in the aforesaid Receivership case as the party in possession of the business, property and effects of the alleged debtor is ordered to notify all the said parties, creditors, stockholders of the issuance of said rule and said hearing in the manner and form of a published notice thereof in the morning *Nashville Tennessean,* said insertion of published notice to appear at a time not less than two weeks prior to July 6, 1935, and to be generally addressed to such parties, creditors and stockholders as aforesaid."
>
> (R., 1-2.)

Various bondholders and creditors did appear and showed cause, and after continuing the hearing over a period of months, the District Judge, in response to the original order permitting the petition to be filed, which was conditioned upon the creditors being permitted to show cause, dismissed the petition for the reasons appearing in the oral opinion delivered on October 23, 1935, the court being of the opinion that while the *motive or intent* of Carmack was proper, the entire proceeding was impractical, and futile, and involved a procedure wholly in violation of the constitutional rights of the bondholders. The District Judge, in so doing, said:

> "It appears to me that the effect of the last plan is to disregard what has been done in the equity receivership case, and to delay a final administration of the debtor's estate indefinitely."
>
> (R., 122.)

He therefore dismissed the petition and ordered the property sold in the equity case.
(R., 123.)

Plans of Reorganization.

In the course of the proceedings held before the District Judge pursuant to the original show cause order upon which the filing of the debtor's petition was conditioned, the debtor filed three different plans of reorganization, with various amendments thereto. These plans and the dates of filing appear in the record, as follows:

July 13, 1935—First Plan of Reorganization.
(R., 34.)

August 31, 1935—Second Plan of Reorganization.
(R., 40.)

October 15, 1935—Amended Plan of Reorganization.
(R., 86.)

October 23, 1935—Third Plan of Reorganization.
(R., 93.)

October 25, 1935—Amendment to Third Plan of Reorganization.
(R., 109.)

Offer of Paul M. Davis.

In the meantime Paul M. Davis, of Nashville, Tennessee, intervened in the cause and offered to purchase the properties covered by the bond mortgage, and to pay the sum of $400,000.00 therefor and to pay an additional sum of $40,000.00 for the assets not covered by the bond mortgage, and further agreed that said offer might be deemed and treated as an upset price if the court ordered the property sold at public auction in the equity receivership cause, the said Davis agreeing to furnish proper guaranties binding himself to appear at such sale and bid the amounts above set out for the properties.
(R., 100A-100B.)

In the course of the proceedings the properties covered by the bond mortgage had been appraised by American Appraisal Company at the sum of $295,585.18.
(R., 66.)

The largest amount offered bondholders in any of the various proposed plans of reorganization was this appraised value. The offer of Paul M. Davis exceeded this appraised value by $100,000.00 and in addition was offered as a minimum bid in event of a judicial public sale.

No creditor of any class, bondholder or unsecured creditor, accepted any of the plans of reorganization. The holders of more than seventy-three per cent of the outstanding bonds intervened in the cause and by proper pleadings disapproved the plans as being impractical, futile, violative of their constitutional rights, not filed in good faith, and demanded that the properties be sold at judicial public sale in the equity proceedings. These pleadings appear in the record, as follows:

C. O. Carpenter, Receiver of Holston-Union National Bank, R., 15, 85, 101.
American National Bank, R., 19, 51, 106.
O. H. Ingram and J. C. Bradford, R., 27, 98.
Paul M. Davis, R., 101.

The objections filed by C. O. Carpenter, Receiver, were both in his capacity as the holder of bonds in the principal sum of $28,000.00 and of an unsecured indebtedness in the sum of approximately $105,000.00 (less any sum received on the bonds which were held as collateral).
(R., 15.)

The Receivers of the Minnesota & Ontario Paper Company, an unsecured creditor to the extent of $121,494.00, filed an answer setting out its unwillingness to consent to or participate in the plan of reorganization filed by Carmack in the corporate debtor's name.
(R., 78, 100.)

With respect to creditors the District Judge found as a fact:

"None of the bondholders are willing to adopt the plan; more than two-thirds of the bondholders have

by pleadings, affirmatively rejected it, and more than 50 per cent of the unsecured creditors have affirmatively declined to accept the plan. If I should adopt it, or, if I should overrule the motion to dismiss the petition, it would amount to cramming down the throats of these secured creditors, a plan which they almost unanimously reject."

(R., 122-123.)

This finding was affirmed by the Circuit Court of Appeals.

(R., 153.)

Although apparently all of the various plans were finally abandoned by the debtor except the one designated Third Plan of Reorganization, they are so interrelated that it is deemed proper, for the convenience of the court, to briefly summarize each of the plans.

First Plan of Reorganization.

This plan was filed July 13, 1935. (R., 34.) It proposed that the value of the bonds and the value of the assets be ascertained by appraisal or by reference, and that this be judicially determined and fixed by the court. The debtor corporation would thereupon issue first mortgage bonds in an amount equal to 100 per cent of the appraised value of its assets, with interest at 5 per cent, and the debtor corporation would offer these bonds for sale and they were to be sold some time within the next seven months at not less than 97 cents on the dollar. If the bonds were thus sold, Carmack, as the holder of the common stock, would make a cash donation equal to any deficiency between the par value of the bonds and the price realized.

This donation and the proceeds from the sale of the bonds (supposedly equaling the appraised value of all of the assets) were to be paid into the court and used to first pay the costs and expense of the bankruptcy proceedings, then the costs of the receivership cause, and then any preferred claims allowed in the receivership cause, and the balance,

if any, was to be distributed between the secured and unsecured creditors and the stockholders of the debtor corporation.

Carmack also proposed to have the insolvent debtor corporation issue preferred stock in the total amount of $100,000.00 to be distributed to unsecured creditors proportionately to make up the difference between the amount received and the amount of such debts. The dividend on this preferred stock was to be 6 per cent non-cumulative, and the stock was non-voting. Class B preferred stock aggregating $25,000.00 was to be divided ratably among the preferred stockholders. $50,000.00 was to be donated to the debtor corporation, which was to be used to take care of the deficiency between the sale price of the bonds and par, if any, and the balance would be used as working capital.

All of this was contingent and conditional upon the court discharging the receivership and immediately turning all of the assets over to Carmack, after which he was to have approximately seven months to sell and dispose of the bonds. The plan also contained certain representations to the effect that Carmack could cut down the operating loss of the newspapers 10 per cent, that is, that his operating loss would be only about 90 per cent of that sustained by the Receiver.

There were certain other immaterial provisions in the plan.

Second Plan of Reorganization.

The debtor apparently perceiving the utter futility and impracticability of the first plan (for example, the sale of bonds at 97 secured only by personal property in an amount equal to 100 per cent of the appraised value of such property), on August 31, 1935, filed what is designated in the record as the "Second Plan of Reorganization," which is said to be a supplement to or an alternative of its previous plan. (R., 40.)

This plan apparently differed from the first plan only in the following particulars: It provided specifically that all the hearings and reports of the Standing Master in the equity receivership cause should be set aside, and that all creditors should be required to again prove their claims in the bankruptcy cause, and that the debtor should not be bound by the previous final determination of the bondholders' rights. The debtor further offered to submit a guaranty or underwriting of the sale of its bonds to the extent of $300,000.00 if the court would approve the alternative plan of reorganization, said guaranty to be furnished within five days after the prior approval of the plan by the court. This was to be the maximum purchase price to be paid by the debtor for all of its assets. (R., 42, 43.)

This plan was subsequently amended so as to provide that the debtor would pay into court the appraised actual cash value of the valid interest, claims or liens on the debtor's property when judicially determined, or take the property covered by the mortgage or deed of trust to secure the bonds at the value shown in the appraisal of the American Appraisal Company (approximately $300,000.00.) (R., 86.)

On October 15, 1935, the District Judge rendered an oral opinion holding that all of the plans previously filed were futile and were violative of the constitutional rights of the bondholders and ordered the petition dismissed. (R., 111.)

Thereupon the debtor filed a third plan of reorganization on October 23, 1935, expressly stating that it was not waiving, abandoning, or in any way reflecting upon its previous plans of reorganization but on the contrary preserving all of its rights with reference thereto.
(R., 93.)

Third Plan of Reorganization.

The third plan of reorganization is difficult to analyze because of its many confusing and inconsistent provisions. The first portion of the plan provided generally for scaling down the indebtedness of the bondholders to 80 per cent of the principal amount, provided the bondholders consented

thereto, a redelivery of the properties to the debtor or some other corporation subject to the reduced bonded indebtedness, and a waiver by the bondholders of all accrued interest, amounting to approximately $146,150.00. (R., 107.) As to non-consenting bondholders, the plan in its first part proposed that the amount due them be "judicially determined." Section VI (R., 97) of this plan would appear to indicate that the plan was conditioned upon non-consenting bondholders' claims being reduced to the actual consideration paid by the various bondholders at the time the bonds were acquired, which were alleged to be less than 80 cents on the dollar. The plan further provided for the payment of $40,000.00 for the assets not covered by the bond mortgage. There was further to be an involuntary extension of the maturity of the bond indebtedness, without the consent of any of the bondholders, for an indefinite time to be determined by the court, at such rate of interest as the court might deem reasonable. The past due sinking fund deposit of $100,000.00 due February 28, 1934, (R., 19), was to be waived and, apparently so were all other future sinking fund requirements.

The first portion of this plan (Sections I to III inclusive) apparently contemplate a redelivery of the property to the insolvent corporation upon its assumption of the bonds at 80 per cent of the principal indebtedness.

Sections IV and V, however, are wholly *antagonistic* to the foregoing provisions and appear to contemplate a sale or a new bond issue and distribution of the proceeds to creditors in some manner. We quote from Section IV:

> "As soon as it is definitely determined how much will be paid the unsecured creditors *from the proceeds of the sale of the proposed bond issue, as above set out*, debtor will issue class 'A' preferred stock. . . ." (Italics ours.)
> (R., 96.)

In Section V it is stated:

> "As soon as it is definitely determined how much will be paid the preferred stockholders *from the pro-*

ceeds of the sale of the proposed bond issue, as above set out, debtor will issue class 'B' preferred stock. . . ." (Italics ours.)
(R., 96.)

This third plan of reorganization was filed after the District Judge had rendered an oral opinion dismissing the proceedings. It is so inconsistent in its provisions that one can not determine whether it involved an assumption of liability in a reduced amount or the execution and sale of new bonds and a distribution of the proceeds in some manner. Two days after the District Judge for the second time had dismissed the proceedings, and on the same day that the final order and decree so dismissing the proceedings were entered (R., 124), a document was filed in the cause entitled "Amendment to Plan of Reorganization Filed October 23, 1935." (R., 109.) This document, instead of being an amendment to the plan of reorganization, in fact appears to be merely a criticism of Mr. L. J. Pardue, the Receiver in the equity suit of *C. O. Carpenter, Receiver,* v. *Tennessee Publishing Company,* and, of course, has no place in the record since it related to an entirely different proceeding.

Motions to Dismiss and Action of the District Judge Thereon.

The District Judge on two separate occasions, after many hearings, sustained the motions of various bondholders to dismiss the entire proceeding, said motions having been made pursuant to the original order to show cause which was a condition precedent to the first decree permitting the debtor's petition to be filed and which was entered on June 6, 1935.

The District Judge found as a fact that the petition was filed in good faith. In so doing it is quite clear from the opinion itself that the court did not have in mind the *legal definition* of good faith but was speaking solely of *intent* and *purpose,* as distinguished from *reasonable possibility of successful reorganization.*

The finding of good faith by the District Judge was predicated apparently upon the following reason:

> "As stated, I can readily see from sentimental as well as from financial reasons that Mr. Carmack would like to become connected with the paper."
> (R., 115.)

The District Judge's finding of good faith based upon motive and intent was reversed by the Circuit Court of Appeals, in the following language:

> "It is clear from the court's memoranda that in deciding the issue of good faith it was guided mainly by a consideration of the honesty of purpose on the part of the debtor in submitting its plan. Section 77(b) does not undertake to define good faith. We think it clear, however, in agreement with the Second Circuit, that something more than sincerity of intention was intended. The purpose of the statute is to relieve distressed debtor corporations, and to provide the mechanics for reorganization where reasonable expectation of continued useful existence may be fairly entertained. This being so, something more must be demonstrated by the debtor than mere honesty or sincerity of purpose. If not, then the way is open to the exploitation of every involved corporation by visionaries whose illusory and optimistic imaginations outrun their business judgments, and the interest of every legitimate creditor is at the mercy of debtors whose sole hope of financial salvation is an abiding faith in miracles. If we are right in this, there was erroneous application of the law in the finding of good faith, and the decree dismissing the petition should upon familiar principles governing appeals in equity be affirmed if right, however erroneous may be any given conclusion of law."
> (R., 156-157.)

Summary of Reasons for Dismissal by District Judge.

The District Judge delivered an oral opinion on October 15, 1935, discussing in detail the plans of reorganization then before him, which provided in substance that the

bondholders would be required against their consent to accept the appraised value of the properties covered by their deed of trust and cancel their obligations, permitting the properties to be returned to the debtor. The District Judge held that any plan containing such provisions violated the Fifth Amendment to the Federal Constitution and he sustained the motion to dismiss upon that ground upon the theory that it would be useless and expensive to go further with the proceedings.

(R., 120.)

After the District Judge had ordered the entire proceedings dismissed, but before a decree was entered, the debtor filed its third plan of reorganization on October 23, 1935, at the same time relying upon and not waiving its previous plans, the new plan (in Section VI) providing, with respect to non-consenting bondholders, for a compulsory scalding down of their obligations in some vague manner apparently either to the appraised value or to what the more recent purchasers had paid for the bonds. (R., 97-98.) Other provisions of this plan have heretofore been set out.

The Court will observe that the beginning paragraph of this third plan of reorganization undertook to recite that its previous plans had been approved by the District Judge as feasible and workable. The District Judge, taking note of these statements, in the *final* opinion again dismissing the debtor's proceeding, commented as follows:

> "Before disposition of the case, I desire to refer briefly to some matters contained in the amended plan which I think should be corrected.
>
> "I do not think the conclusions reached by the draftsman of the amended plan, filed October 23, 1935, are in all respects supported by the oral opinion delivered from the bench on October 15th. In the preliminary statement to the present amended plan, it is stated that the Court held that the plans that had, at that time been filed, appealed to the Court as feasible and workable, and that he would have been pleased to approve the plan, except, that same was not ap-

proved by two-thirds of the bondholders, and therefore, was violative of the Fifth Amendment to the Constitution of the United States; and that the Court stated that if the plan provided for the retention by the debtor of its property, subject to the claims and interest of the secured creditors, in the Court's opinion, would have been constitutional, and violate no rights of the secured creditors.

"What the Court said upon that question was, that the plan was proposed in good faith, and as an evidence of good faith, it contained certain provisions relative to unsecured creditors, stockholders, etc., which appealed to him, *but I did not say that the plan was feasible and workable, and that, but for the lack of approval by two-thirds of the bondholders, I would be glad to approve it.* On the contrary, it was stated, 'I do not intend now to say, or to intimate, that in the event I should overrule the motion to dismiss the petition, that the plan proposed will be approved by the Court.' It was further stated, in reference to the proponents' ability to carry out the provisions of the plan, that the Court 'had no reason to doubt that they can do just what they say they can do' in this regard.

"I think the draftsman of the amended plan misconstrued the language of the Court. I admit the conclusions of the Court were poorly stated, *but I do not think what was said would justify the conclusion that the plan appeared to the Court to be workable and feasible, and that, but for the Constitutional questions, I would approve it.* I could not properly have said that because at that time, the case was not in such condition as to justify an expression of opinion as to whether the plan would be approved or not." (Italics ours.)

(R., 121, 122.)

The District Judge thereupon proceeded to consider the debtor's latest plan, and his conclusions with respect thereto may be summarized as follows:

(1) That the validity and amount due the bondholders had been finally determined in the equity proceedings in the case of *Carpenter, Receiver,* v. *Tennessee Publishing*

Company, and that the debtor was a party to that suit and had made no objections to the report of the Standing Master, and that it would work an injustice to reconsider the matter and undertake to undo what had already been finally determined in the equity proceedings. (R., 122.)

(2) That the debtor admitted, and the fact was abundantly shown by the report of the Standing Master in the equity case, that Tennessee Publishing Company was *notoriously insolvent*. (R., 122.)

(3) That in view of the notorious insolvency of the debtor the *effect* of this proceeding would be to disregard what had been done in the equity receivership case and to delay the final administration of the debtor's estate indefinitely. (R., 122.)

(4) That none of the bondholders were willing to adopt the plan; more than two-thirds of the bondholders had by pleadings affirmatively rejected it, and more than 50% of the unsecured creditors had affirmatively declined to accept the plan. Under these circumstances for the court to approve the plan "would amount to cramming down the throats of these secured creditors a plan which they almost unanimously rejected," and would take from them the substantive rights which they had in the property and, under the most liberal construction of the plan, would violate the Fifth Amendment to the Federal Constitution. (R., 123.)

(5) That in view of the financial condition of the debtor a sale of its property was *inevitable* and that the bondholders (whose property rights were acquired in 1928 prior to the enactment of Section 77B) were entitled to a judicial sale of the property under the opinion of the Supreme Court of the United States in the case of *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S., 555. (R., 123.)

(6) That the petition should therefore be dismissed and the property sold in the equity case. (R., 123.)

The learned Circuit Court of Appeals concurred in all of the above findings of fact and affirmed the action of the District Judge in dismissing the proceedings.

(R., 151-160.)

It is submitted that there was no error in the action of the District Judge or the Circuit Court of Appeals and that the writ of *certiorari* granted in this case should be dismissed as inadvertently issued, for the reasons now to be set forth.

PROPOSITIONS OF LAW.

I

Speculators in equities were not within the contemplation of Congress in the passage of Section 77B as an amendment to the Bankruptcy Act. An individual who acquires control of a notoriously insolvent corporation in order to attempt a reorganization for a speculative profit is not acting in good faith.

Fletcher's Cyc. Corps., Vol. I, § 41, p. 134.
Pierce v. *National Bank of Commerce,* 13 F. (2d), 40.
Majestic Co. v. *Orpheum Circuit,* 21 F. (2d), 721.
In re Cosgrove, 10 F. Supp., 672.
In re Philadelphia Rapid Transit Co., 8 F. Supp., 55, (affirmed without opinion, 73 F. (2d), 1022).
In re North Kenmore Bldg. Corp., 81 F. (2d), 656.
In re Francfair, Inc., 13 F. Supp., 513.
Shapiro v. *Wilgus,* 287 U. S., 348, 77 L. Ed., 355.

II

"Good faith," as used in Section 77B of the Bankruptcy Act, requires more than mere honesty of purpose or sincerity of intent. Where it is apparent that because of the notorious insolvency of the debtor there is no reasonable expectation of a successful reorganization, the proceeding must be dismissed as not filed in good faith.

In re 235 West 46th Street Co., 74 F. (2d), 701.
In re Williamsport Wire Rope Co., 10 F. Supp., 481, (approved and appeal dismissed, 78 F. (2d), 1023).
Manati Sugar Co. v. *Mock, et al.,* 75 F. (2d), 285.
In re Philadelphia Rapid Transit Co., 8 F. Supp., 55, (affirmed without opinion, 73 F. (2d), 1022).
In re Sterba, 74 F. (2d), 413.
In re Electric Public Service Co., 9 F. Supp., 128.

III

The District Judge and the Circuit Court of Appeals concurred in the finding that the plans proposed by the debtor

were not feasible and that it would be unfair to the bondholders to further delay a sale of the properties because of the notorious insolvency of the debtor and the increasing losses in operations under the receivership. These findings are conclusive in this Court unless clearly erroneous.

Continental Illinois Nat'l. Bank & Trust Co. v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S., 648, 79 L. Ed., 1110.
In re Murel Holding Corp., 75 F. (2d), 941.
Preble Corp. v. *Wentworth, et al.*, 84 F. (2d), 73.
Francisco Bldg. Corp., Ltd. v. *Battson*, 83 F. (2d), 93.

IV

Bondholders whose substantive rights in specific properties arose and existed prior to the passage of Section 77B as an amendment to the Bankruptcy Act can not be deprived of such substantive rights without their consent, and to do so would violate the Fifth Amendment to the Constitution of the United States.

Louisville Joint Stock Land Bank v. *Radford*, 295 U. S., 555, 79 L. Ed., 1593.
In re Lowmon, 79 F. (2d), 887.
In re Young, 12 F. Supp., 30.
In re Sherman, 12 F. Supp., 297.
In re Tschoepe, 13 F. Supp., 371.
In re Schoenleber, 13 F. Supp., 375.
In re Davis, 13 F. Supp., 221.
In re Diller, 13 F. Supp., 249.
Robert Page Wright v. *Vinton Branch, etc. Bank*, and five other cases. (Decided October 6, 1936, by Circuit Court of Appeals for Fourth Circuit, not yet reported.)

ARGUMENT.

I.

Proceeding Purely Speculative.

As has been previously pointed out and concurrently found by the District Court and the Circuit Court of Appeals, this proceeding originated out of the purchase of the entire common stock of Tennessee Publishing Company by E. W. Carmack, Jr., on June 5, 1935, just one day before the petition was filed. Carmack and his mother, prior to that time, owned a beneficial interest in only 5% of the preferred stock of the corporation. He had not in any way been associated with the newspapers published by the debtor and his ownership of the preferred stock came from his father, who died 27 years prior to the filing of this petition. Carmack frankly states that he devised the plan of acquiring the common stock of the debtor for the sole purpose of having himself elected editor-in-chief of the newspapers and because he felt that he could profit financially from the venture.

At the time this purchase was made the debtor's affairs were being administered by a receiver, under a general creditors' bill filed and sustained more than two years prior to the purchase. The insolvency of the debtor was described by the District Judge as "notorious." Its secured obligations, including interest, amounted to approximately $900,000.00, its unsecured obligations exceeded $300,000.00, and it had outstanding $300,000.00 in preferred stock—which meant that the debtor would be required to have assets equal to $1,500,000.00 before the common stock would have any asset value. The appraised value of the assets, and indeed the maximum amount offered by the debtor for the purchase of all of the assets, is a little over $300,000.00. Upon such a valuation the bondholders and unsecured creditors would receive only a fractional amount upon their claims, the preferred stock would be worthless, and the common stock was of no value. Under these circumstances Carmack negotiated for and acquired the common stock, had a new

board of directors elected, which in turn elected Carmack president, and simultaneously authorized him to file these proceedings—and Carmack admits in his "explanatory petition" that this was "in furtherance of the trade which had been made by said Carmack." (R., 81.) After filing the petition in the name of the corporate debtor, Carmack then proceeded to sell and dispose of a substantial interest in the common stock, which sale was contingent upon the court's sustaining this proceeding and approving the plan of reorganization. (R., 79.) Carmack's real position was adequately stated by the District Judge in his oral opinion, in the following language:

> "As stated, I can readily see from sentimental as well as from financial reasons, that Mr. Carmack would like to become connected with the paper."
> (R., 115.)

When the Court looks through the corporate fiction it will appear that the entire effort to reorganize the corporation is by E. W. Carmack, Jr., personally, and that it arises out of his desire to acquire the newspapers for financial reasons. The courts always have disregarded the corporate fiction in the interest of justice and fair dealing.

> "The existence of the corporation as a distinct entity is a legal fiction, and where to recognize the corporation as a distinct legal entity will justify wrong, protect fraud, or defend crime, the law will disregard this fiction and view the corporation as an association of persons. *McCaskill Co.* v. *U. S.*, 216 U. S., 504, 30 S. Ct., 386, 54 L. Ed., 590; *U. S.* v. *United Shoe Machine Co.* (D. C.), 234 F., 127; *Smith* v. *Moore*, 199 F., 680, 118 C. C. A., 127; *Linn & Lane Timber Co.* v. *U. S.*, 196 F., 593, 116 C. C. A., 267; In re Watertown Paper Co., 169 F., 252, 94 C. C. A., 528; *U. S.* v. *Milwaukee Refrigerator Transit Co.* (C. C.), 142 F., 247; Fletcher, Cyclopedia of Corporations, Vol. I, § 42; 14 C. J., p. 61, § 22."
>
> *Pierce* v. *National Bank of Commerce*, 13 F. (2d), at pp. 47-48.

> "The corporation will be regarded as a legal entity as a general rule, and the courts acting cautiously and

only when the circumstances justify it, will ignore the fiction of corporate entity, where it is used as a blind or instrumentality to defeat public convenience, justify wrong, or perpetrate a fraud, and will regard the corporation as an association of persons. *Peckett* v. *Wood*, (1916 C. C. A., 3d Cir.), 234 F., 833; *New York Trust Co.* v. *Carpenter* (1918, C. C. A., 6th Cir.), 250 F., 668." (Citing other cases.)

Majestic Co. v. *Orpheum Circuit*, 21 F. (2d), 720.

We, therefore, respectfully insist that this proceeding should in equity be regarded as having been instituted by E. W. Carmack, Jr., personally, as a stockholder, rather than by the corporate debtor.

The recent case of *In re Cosgrave*, 10 F. Supp., 672, involved a proceeding under Section 74 of the Bankruptcy Act. Here an individual filed a debtor's petition and recited that she was the owner of an apartment house in the City of Los Angeles, which was subject to a deed of trust to secure a large indebtedness. On an order to show cause the trustee under the deed of trust moved for a dismissal of the proceeding on the ground that it was not brought in good faith, as the statute required. The debtor was called as a witness and it developed that she had no interest in the apartment house prior to December 10, 1934, although she had resided, for the past few months, with her husband in the apartment house, and he was the bookkeeper for the company. It appeared that she had paid $300.00 in cash and had given notes aggregating $1,700.00, and had agreed to assume certain current expenses, which was to be complete payment for the equity in the property. Seven days later she filed the petition claiming relief under Section 74 of the Bankruptcy Act.

Prior to the time the petitioner acquired the equity in the apartment house the trustee under the trust deed had filed an action in the state court seeking the appointment of a receiver and the hearing on the motion for appointment of a receiver was set for December 17, 1934. The debtor's petition was filed on December 17, 1935, and while

she claimed that the apartment house was worth an amount in excess of the encumbrances the court concluded from certain affidavits that the property was not sufficient to pay off the mortgage indebtedness. Under these circumstances the District Judge held that the petitioner was not a *distressed debtor* within the meaning of the Bankruptcy Act but was in fact one who was speculating in equities and therefore the petition was not filed in good faith. The case is closely analogous to the one at bar, as will be seen from the following quotation:

> "The question here is: Can an individual suddenly acquire an equity in property for a nominal amount, and proceed immediately to claim the benefits of Section 74 of the Bankruptcy Act? The provisions of that section were intended to secure relief to persons who, engaged in any business, and finding themselves embarrassed by debts accumulated in the past, desire the opportunity to submit terms of compromise to their creditors. Speculators in equities surely were not within the contemplation of Congress when it drafted the section. The question of good faith is one which the court is obliged to consider—'good faith' means that the proceeding is brought by a person within the contemplation of the act, and under circumstances which warrant the assumption that some form of fair compromise may be worked out with creditor interests. The provisions were never intended to merely stay the hands of creditors, and leave unmolested the property in possession of the debtors who might continue to derive the income therefrom. The very fact that the petitioner acquired the equity in a large property at such a nominal figure contradicts in itself the assertion that the property has a value greatly in excess of the encumbrances against it. The facts and circumstances connected with the acquiring of the equity as shown here, demonstrate that the sole purpose of the dealings made by the petitioner was to enable her to prosecute a proceeding under Section 74, in order that the foreclosure of the trust deed encumbrances should be prevented."
>
> *In re Cosgrave*, 10 F. Supp., at p. 673.

District Judge James, in the foregoing opinion, pointed out the fact that a similar decision had been reached with respect to an alleged farmer's petition in the United States District Court for the Western District of New York in the Matter of Fullagar, 8 F. Supp., 602. The petition was dismissed.

A similar situation was presented and discusssed by the Federal District Judge in *In re Philadelphia Rapid Transit Co.*, 8 Supp., 51, (affirmed without opinion, 73 F. (2d), 1022). In that case three persons had acquired the status of creditors and, as such, proceeded to file a petition under Section 77B of the Bankruptcy Act and, as in the case at bar, the petition was accompanied by a criticism of the previous management of the corporation's affairs, and plans for reorganization were proposed. The court said:

> "It is easy for any three persons to acquire the status of creditors so as to meet this requirement. The petitioners have done this but this is not enough. The petition must be 'in good faith.'"

Again the court said:

> "The comment we have made is directed to the meaning of Section 77B. We think it means that the proceeding provided is to be invoked either by the corporation concerned or by its creditors. This is the meaning of the 'good faith' phrase used in the act. It does not, as we have said, refer to the purity of the motives of the petitioners, nor, on the other hand, does it mean that the petitioners have merely technically qualified as creditors. They must be found to be speaking for the corporation or as creditors."

The duties of the District Judge in passing upon "good faith" were defined as follows:

> "There has been a compliance with the formalities. The act, however, requires more of the 'judge' than a certification to such compliance. He must find 'good faith.' This is more than a formality. It goes to the very vitals of the petition. If it is not a real creditors'

petition, although it may be signed by three persons who have the technical status of creditors, it is not 'in good faith' a creditors' petition. No better illustration could be found of the distinction attempted to be expressed than is afforded by this very petition."

After commenting on the fact that the petitioner and two others joined together and purchased certain bonds solely for the purpose of filing the petition, the court said:

"The mistake made was in assuming that, if he complied with all the formalities required by the act of Congress, he could bring himself within its provisions. He has overlooked the second requirement of substance that the petition must be 'in good faith' a creditors' petition. He has further assumed, as his counsel have argued, that the averments of the petition must be taken as verities until the facts have been judicially determined in accordance with the leisurely methods of legal procedure. He again has overlooked the requirement that the 'judge' must summarily determine the fact of compliance with the formalities and likewise the fact of 'good faith.'"

In conclusion the court found, as follows:

"The real purpose and motive behind the position existed before they became creditors *and they became creditors solely as an aid in the accomplishment of this purpose.* This was frankly admitted in the argument at bar. *They bought their way in as creditors and presumably can sell their way out.*

"The petition is not in truth a real creditors' petition and in this sense is not in good faith. Approval should in consequence be denied." (Italics ours.)

In re Philadelphia Rapid Transit Co., 8 F. Supp., at pp. 54-55.

The Circuit Court of Appeals for the Seventh Circuit has recently applied this principle in a 77B proceeding quite similar to the present case, in its decision in *In re North Kenmore Bldg. Corp.*, 81 F (2d), 656. In that case the mortgage indebtedness exceeded the value of the property.

A bill had been filed to sell the property under the first mortgage. The individual owners of the property quitclaimed to their attorneys, who in turn formed a corporation for the purpose of filing a proceeding for reorganization under Section 77B. Eighty-two per cent of the bondholders opposed the proposed reorganization as futile and the proceeding was dismissed by the Circuit Court of Appeals for the Seventh Circuit. In the course of the opinion, the court said:

> "That appellee has no equity in this property, other than of a speculative value, is a matter not open to serious doubt. In the matter of *In re Cosgrave* (D. C.), 10 F. Supp., 672, 673, Judge James, the learned Senior District Judge of the Southern District of California, in dismissing for lack of good faith a debtor's petition under section 74 of the Bankruptcy Act (as amended (11 U. S. C. A. § 202), said: 'Can an individual suddenly acquire an equity in property for a nominal amount, and proceed almost immediately to claim the benefits of section 74 of the Bankruptcy Act? The provisions of that section were intended to secure relief to persons who, engaged in any business, and finding themselves embarrassed by debts accumulated in the past, desire the opportunity to submit terms of compromise to their creditors. Speculators in equities surely were not within the contemplation of Congress when it drafted the section. . . . "Good faith" means that the proceeding is brought by a person within the contemplation of the act. . . . The very fact that the petitioner acquired the equity in a large property at such a nominal figure contradicts in itself the assertion that the property has a value greatly in excess of the encumbrances against it. The facts and circumstances . . . as shown here, demonstrate that the sole purpose . . . was to enable her to prosecute a proceeding under section 74, in order that the foreclosure . . . be prevented.'
>
> "We think this is a fair statement of the purpose of section 74, and the language there used is applicable to the instant situation. The fact that more than 82 per cent of the bondholders, who are in fact the real owners of the property in question, have arrayed them-

selves in opposition to the proposed plan of this new corporation, also weighs heavily in the determination of the question of the good faith of the petitioner."

In re North Kenmore Bldg. Corp., 81 F. (2d), at p. 657.

In the cause of *In re Francfair, Inc.*, 13 F. Supp., 513, the District Judge dismissed the debtor's petition for reorganization under Section 77B, where the mortgage indebtedness exceeded the value of the property which was transferred to a corporation in exchange for the entire capital stock, the court saying:

"Moreover, a petition filed on January 15, 1935, to reorganize a corporation organized January 2, 1935, for the purpose of acquiring a piece of real estate already under foreclosure and encumbered by liens exceeding its value and transferred to it by trustees of a trust in consideration of all the stock of the corporation, the trust so far as the record shows being solvent and continuing in control of the property, cannot be considered to have been filed in good faith. Compare *Shapiro* v. *Wilgus*, 287 U. S., 348, 53 S. Ct., 142, 77 L. Ed., 355, 85 A. L. R., 128."

In re Francfair, Inc., 13 F. Supp., at p. 514.

Carmack, the owner of the entire common stock of the debtor corporation, is not a distressed debtor as contemplated by the Bankruptcy Act. He is not attempting to protect any fixed interest owned by him prior to the passage of Section 77B as an amendment to the Bankruptcy Act. He admits in his pleadings that he is interested in the reorganization for his own financial aggrandizement and that he acquired the common stock on the day before the properties were to be ordered sold for the purpose of having himself elected president of the corporation and filing the petition for reorganization. The previous owners of the common stock, whose acts had brought the corporation to a state of notorious insolvency, had not only abandoned all efforts to reorganize but had in fact abandoned the properties themselves. This court dealt with an analogous situation in *Shapiro* v. *Wilgus*, 287 U. S., 348, 77 L. Ed., 355, saying (at p. 355):

> "It would not gain validity when he transferred the business to another with a capacity for obstruction believed to be greater than his own."

It is submitted that the above statement from the opinion of Mr. Justice Cardoza aptly describes the situation in the present case, and that Carmack's own admissions convict him as a speculative adventurer in the equity of a notoriously insolvent corporation, which should bar him from the benefits claimed under Section 77B of the Bankruptcy Act.

II.

Reorganization Neither Feasible, Fair nor Practicable.

Under the provisions of Section 77B of the Bankruptcy Act a District Judge is given a wide discretion in determining whether or not the plans proposed are practicable or feasible. In the instant case the District Judge had himself administered the affairs of the debtor corporation for over two years under a receiver in a general creditors' proceeding. The liquidation under this proceeding had progressed to the point where only a sale of the properties remained to be accomplished and a hearing was set for the purpose of ordering such a sale on June 6, 1935. In all of these proceedings the debtor corporation was a party and participated freely therein, receiving notice of each step taken, and made no exceptions. A reference had been made to the Standing Master to ascertain the amount of the indebtedness, the liens, and status of all creditors, and extensive hearings had been completed and the Standing Master had filed his final report and, with the exception of certain immaterial disputed claims, his report had become final.

The amendment known as Section 77B had been on the statute books exactly one year prior to the date set for the order of sale. For several years prior to the receivership the corporation had operated its business at a large annual loss. The receiver, notwithstanding careful management, also was operating at a loss. The properties were of such a nature that any failure to publish the papers would result in certain and almost complete disaster. The

presses on which the papers are printed are old and out of repair. The receiver had borrowed money which has not been repaid and counsel fees, receiver's compensation and other costs must be paid. The assets, according to an appraisal relied on by the debtor, are worth only about $350,000.00. Its admitted liabilities exceed $1,000,000.00. The validity of the lien to secure the bonds and the amount due on the bonds have been judicially and finally determined in the receivership proceedings. Th District Judge's comment was that the debtor was "notoriously insolvent."

Under these circumstances Paul M. Davis, one of the bondholders, came forth and made an offer to pay $400,000.00 in cash for the assets covered by the bonds and $40,000.00 for the free assets, and agreed that this offer might be used as a starting bid if the court desired to sell the property at public auction. This figure was $140,000.00 more than the debtor was offering in its various plans of reorganization.

The foregoing facts were commented on by the District Judge in his final opinion delivered October 23, 1935. The District Judge in the exercise of his sound discretion refused to permit the equity receivership proceedings to be undone and pointed out that none of the bondholders had approved the plan, more than two-thirds of the bondholders had filed pleadings to reject the plan, more than 50 per cent of the unsecured creditors had done likewise, and that under all of the circumstances a judicial public sale of the properties was inevitable, and for this reason he dismissed the petition so that they might be sold in the equity case.

The Circuit Court of Appeals described the debtor's situation as follows:

> "It appears from the record that the total assets of the debtor upon fair appraisal are worth less than $300,000. The bonded indebtedness exceeds $900,000.00, and the unsecured indebtedness is more than $300,000. To this must now be added the cost and expenses of the receivership. Moreover, the receiver has been operating at a loss, and the debtor concedes

> that it also will for a time operate at a loss, its most optimistic undertaking being, if the property is restored to it, to reduce current losses 25 per cent. When these figures are considered together with the vagueness of detail in the proposed plan, the doubt that exists as to whether under Section 77B there may now be a reopening of the adjudication of the claims against the debtor in the equity proceeding it seems clear to us that the proposed plan is not a workable plan, offers no reasonable prospect for successful rehabilitation of the debtor, and is in consequence not, in the sense the phrase is used in the section, presented in good faith." (R., 157.)

The District Judge and the Circuit Court of Appeals are supported in these conclusions by both common-sense reasoning and precedent.

In the case of *In re 235 West 46th Street Co., Inc.*, 74 F. (2d), 700, the Circuit Court of Appeals for the Second Circuit was dealing with the following situation:

After a mortgage foreclosure had been commenced by the first mortgagee on property known as the Paramount Hotel in New York City and a receiver of the properties had been appointed by the state court, the debtor filed a petition under Section 77B of the Bankruptcy Act and the District Judge entered an order permitting it to be filed. The application was opposed by the mortgagee upon the ground that there was not equity above the first mortgage and that a sale thereunder was inevitable. There were a number of adjournments and in all four plans of reorganization were submitted. It was admitted that the mortgage indebtedness exceeded the value of the property and that the hotel was being operated at a loss. In holding that the petition should be dismissed the appellate court said:

> "The difficulty would seem to be that the first lien on this property, and the arrears of interest and taxes, leave no equity. The hotel and restaurant business has been unprofitable. It appears that the trustee now named managed the property for three years and three months while the first mortgage was in default of in-

terest and taxes, and under his management the property consistently failed to pay taxes and interest on the first mortgage to the extent of $330,000. Full opportunity has been allowed for the submission of plans. The extraordinary powers possible to utilize under Section 77B have not been of assistance to appellees. We are not warranted in believing that there is a reasonable prospect for a reorganization beneficial to all. To grant more time, there must be a showing that there is a fair opportunity to sustain the appellee's claim that the corporation can be reorganized for the benefit of all. We think the liberal powers conferred by the section and their exercise in enjoining foreclosure of the first mortgage should no longer stay the appellants. It would be an abuse of the powers granted by Section 77B, under the circumstances found in the case, to further stay the appellants in the hope that eventually some other plan of reorganization might be proposed."

In re 235 West 46 Street Co., Inc., 74 F (2d), at pp. 701-702.

In the case of *In re Williamsport Wire Rope Co.*, 10 F. Supp., 481, (approved and appeal dismissed, 78 F. (2d), 1023), the debtor corporation, as in the case at bar, had been administered in an equity receivership cause for about two years, in which cause its affairs had been practically liquidated. When the debtor filed the petition in bankruptcy it was opposed by the bondholders who were interested in working out their rights in the equity receivership cause, upon the ground that it was not in good faith within the meaning of Section 77B because there was no reasonable hope of obtaining acceptance of the plan in the amount required by the statute; because the plan, unless accepted by the requisite number of bondholders and creditors, could not be confirmed by the court; and because the plan itself was not feasible and there was no reasonable prospect of its success. Notwithstanding an apparent equity over the indebtedness in favor of the stockholders, the court dismissed the debtor's petition as not filed in good faith, with the following comment:

"The present receivership in equity has been and is making progress. This court is not averse to reorgani-

zation, yet it is not disposed to terminate the receivership in equity and place the Williamsport Wire Rope Company in the hands of trustees under Section 77B until there is at hand an adequate offer, based on a feasible, practicable, and acceptable plan which will result in a fairly speedy reorganization with likelihood of success and which will adequately protect all the investors and creditors as their relative interests merit.

"The court is of the opinion that it will result in confusion and uncertainty of policy to terminate the equity receivership and place the Williamsport Wire Rope Company in the hands of trustees under Section 77B based only on the present company plan which is not adequate, feasible, or acceptable.

"Detailed requests for findings of fact and conclusions of law have been submitted. They are answered and filed herewith and made a part of this opinion.

"For the reasons above stated, the court is of the opinion that the petition for reorganization under Section 77B was not filed in good faith and should be dismissed."

In re Williamsport Wire Rope Co., 10 F. Supp., at p. 482.

The case of *Manati Sugar Co.* v. *Mock*, 75 F. (2d), 284, is directly in point. In that case the properties were widely scattered and were subject to first mortgage bonds exceeding $5,000,000.00. A receiver in equity was appointed on February 9, 1932, and it continued the business under the authority of the court, arranging for the necessary credit to do so. Default had occurred in the principal and interest under the bonds. The debtor was without working capital and was dependent upon bank loans.

The petitioner creditors who sought reorganization under Section 77B of the Bankruptcy Act owned $14,000.00 of the principal amount out of the total bonds exceeding $5,000,000.00. The petition strictly conformed to the averments required by the statute. The petition was dismissed, however, as not being filed in good faith and the court defined the requirements of good faith as follows:

"To conclude that a petition is filed in good faith, there should be a showing, found within it, of a need for a reorganization. The good-faith provision of the statute is not satisfied merely by honesty and good intentions. There must be a showing that the petitioners have a basis for expecting that a reorganization can be effected. Where the object is reorganization, rather than liquidation, the petitioner should furnish some assurance, by allegations at least, that they reasonably expect a fairly general support for their proposed plan or promised plan. Otherwise there would be little to be expected in the undertaking of assuming responsibility for a reorganization.

. . . . . .

"But it must appear that there is reasonable probability that a reorganization will be effected. In other words, the question presented is whether there may be reasonably applied to the debtor some feasible and practicable plan of reorganization. If not, there is no occasion to invoke the benefits of the act."

Manati Sugar Co. v. *Mock*, 75 F. (2d), at p. 285.

The court concluded upon the facts first above stated that there was no reasonable prospect of a successful reorganization and hence the petition was dismissed.

Who is better qualified to exercise a sound discretion in the case at bar than the District Judge in whose court for more than two years the affairs of the Debtor corporation have been liquidated under an equity receivership? After a general survey of the situation he, for the reasons announced in his final opinion, determined that a sale of the properties was inevitable and he dismissed the debtor's petition as not being filed in good faith, because it was impracticable and not feasible, and for the purpose of permitting a sale of the properties in the equity receivership cause. In so doing he was amply supported by the facts as we have pointed out and it can not be disputed that such dismissal was required by the legal principles set out in the foregoing cases.

III.

No Error in Concurrent Findings of the District Court and Circuit Court of Appeals.

Sub-section (f) of Section 77B of the Bankruptcy Act provides that the District Judge shall confirm a plan of reorganization if he is satisfied "that it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible." If the District Judge reaches the conclusion that the proposed reorganization is unfair, inequitable, discriminatory, or not feasible, he is authorized to dismiss the proceeding under sub-section (c) (8) of Section 77B of the Bankruptcy Act.

In ascertaining the basis of the District Judge's action in dismissing the proceeding, it is important for the court to bear in mind that while an oral opinion was delivered by the District Judge on October 15, 1935, the final opinion, in which the District Judge summarized his entire position, was delivered on October 23, 1935. (R., 121-123.) For the convenience of the court we here quote the statements of the District Judge made in the course of his final opinion, which clearly indicate his reasons for dismissing the proceeding:

> (1) "I believe it would manifestly be unjust to the bondholders to undo what has been done in the equity proceedings of the case of *Carpenter, Receiver* v. *Tennessee Publishing Company.* In that case the validity and amount of the bonds outstanding was established. The debtor was a party to that suit; the question was submitted to the Standing Master and he made his report covering that question. The report, I am informed, is unexpected to. Hence it would result in a very great injustice to everyone to reconsider the validity and amount of the bonds, and undo what has been done in that case. These two cases have been going along together, and being tried and considered together, in all the hearings that have been before the Court."
>
> (R., 122.)
>
> (2) "It is admitted, and in fact, is abundantly shown by the report of the Standing Master in the.

equity case, that the debtor is notoriously insolvent."
(R., 122.)

(3) "In view of the bankrupt condition of debtor, I am unable to see how the bondholders could possibly realize the value of their bonds, or how the value of the bonds are to be ascertained except by a public sale of debtor's property securing same. It appears to me that the effect of the last plan is to disregard what has been done in the equity receivership case, and to delay a final administration of the debtor's estate indefinitely."
(R., 122.)

(4) "None of the bondholders are willing to adopt the plan; more than two-thirds of the bondholders have by pleadings, affirmatively rejected it, and more than 50 per cent of the unsecured creditors have affirmatively declined to accept the plan. If I should adopt it; or, if I should overrule the motion to dismiss the petition, it would amount to cramming down the throats of these secured creditors, a plan which they almost unanimously reject. I would be taking from them a substantive right that they have in the property, and the very best that could be said of it—the best excuse that the Court could offer—would be that it would postpone their right to a public sale of the property to such time as the Court might see fit to sell it. That is the most liberal construction in favor of the plan."
(R., 122-123.)

(5) "In view of the financial condition of debtor, a sale of its property is inevitable. . . ."
(R., 123.)

(6) ". . . and if I should adopt the last plan of the debtor which provides for scalding down of the face value of the bonds from one dollar to eighty cents, and returning the property to debtor, subject to the lien now existing in favor of the bondholders after crediting same with twenty cents on the dollar, and the court to fix a rate of interest the debtor is to pay upon said bonds after crediting the same aforesaid, and if the court should judicially determine the value of the bonds which are held by bondholders who are unwilling to accept eighty cents on the face value thereof,

which amounts so fixed shall be declared to be the value of said bonds. Or, in the event the holders of said bonds are not willing to take the amounts thus fixed by the Court, in that event, the debtor to retain possession of its property subject to the lien now existing thereon to secure whatever amount the Court may determine is due would be, as announced by the Supreme Court in the case of *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S., 555, depriving the bondholders of substantive rights which cannot legally be done."

(R., 123.)

(7) "I can see no alternative except to dismiss the petition, and let the property be sold in the equity case."

(R., 123.)

The District Judge, at the time of this pronouncement, had before him the debtor's proposals based generally upon the appraisal of the properties covered by the mortgage at approximately $300,000.00, *and also had before him the offer to Paul M. Davis to pay $400,000.00 for these same properties and $40,000.00 for the assets not covered by the lien of the bonds and to permit his offer to be used as an upset bid if the properties were sold in the equity case.*

(R., 100A-100B.)

We have heretofore quoted the statement of the learned Circuit Court of Appeals concurring in the foregoing findings of the District Judge that the financial condition of the debtor was such as to require a sale in the equity proceeding at the earliest moment.

(R., 157.)

The statement of the District Judge set out in paragraph (3) above is of controlling importance in view of subdivision (b), clause (5) of Section 77B, which places the duty upon the District Judge of seeing that any plan provides adequate protection to creditors for the realization of the value of their interests

"... (1) by such method as will in the opinion of the judge, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection."

In the case of *In re Preble Corp.*, 84 F. (2d), 73, (*certiorari* granted and now pending in this Court), the Circuit Court of Appeals for the First Circuit refused to confirm a plan of reorganization filed by the debtor, which provided that dissenting bondholders were to receive the appraised value of their claims, although the value of the real estate was found to be less than the mortgage debt, and applied the test established by Judge Learned Hand in the case of *In re Murel Holding Corp.*, 75 F. (2d), 941. The Circuit Court of Appeals quoted and approved the following statement of the District Judge:

> "'A plan may not be confirmed if it is not fair and equitable, or if it discriminates in favor of one class of creditors or stockholders or is not feasible. In such a case as this, to take the property from the mortgagee upon an appraisal is an attempt to use a supposed or possible value, over and above the appraisal, for the benefit of other creditors and stockholders. If there is any such surplus value, it belongs to the first mortgagee, up to the amount of his debt. If there is none, there is nothing to build on, and there would seem to be no object in having an appraisal, in the absence of a disclosure of a method of raising the money, unless junior interests are prepared to advance the money on a chance of increased value in the future, and there is no information before the court to that effect. A plan cannot be called either fair or feasible which discloses no method or probability of being carried out unless, perchance, the appraisers make a mistake in valuation.' We agree with this view, and it is decisive."

Likewise, in *Francisco Bldg. Corp., Ltd.*, v. *Battson*, 83 F. (2d), 93, the Circuit Court of Appeals for the Ninth Circuit refused to confirm a plan of reorganization proposed by the debtor over objections of the bondholders, which provided for the surrender of all outstanding bonds and the issuance of new income bonds. The facts relating to insolvency of the debtor were analogous to those in the case at bar and the operation by the trustee in possession of the properties was not producing sufficient net income to pay the accrued interest on the first mortgage bonds.

Ninety-two per cent of the bondholders objected to the plan and the District Judge sustained their objections and dismissed the proceeding. The Circuit Court of Appeals said:

> "It is too obvious to require discussion that there is no abuse of discretion in refusing to approve the proposed plan of reorganization. *In re Murel Holding Corporation, supra; In re Coney Island Hotel Corporation, supra.* We therefore content ourselves with citing a number of additional authorities bearing on the question. *In re Central Funding Corporation* (C. C. A.), 75 F. (2d), 256; *In re Murel Holding Corporation* (C. C. A.), 75 F. (2d), 941; *Louisville Joint Stock Land Bank* v. *Radford,* 295 U. S., 555, 55 S. Ct., 854, 79 L. Ed., 1593, 97 A. L. R., 1106; *In re North Kenmore Building Corporation,* 81 F. (2d), 656, decided by the United States Circuit Court of Appeals for the Seventh Circuit, January 31, 1936; *Central States Life Ins. Co.* v. *Koplar Co.,* 80 F. (2d), 754, decided by the United States Circuit Court of Appeals for the Eighth Circuit, December 17, 1935."

The point we are now presenting is wholly aside from the *constitutional question,* which will be presented in Section IV of this brief. The District Judge was of the opinion that in view of the bankrupt condition of the debtor the bondholders could not possibly realize the value of their bonds except through a public sale of the debtor's properties under the trust indenture, and that such was the only fair and feasible method of determining the value of the bonds. The Circuit Court of Appeals concurred. The case therefore falls within the principle announced by this Court in *Continental Illinois Nat'l. Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry. Co.,* 294 U. S., 648, 79 L. Ed., 1110, in which Mr. Justice Sutherland said, *at page 1129:*

> "It is evident that the effect here wrought by the menace of impending sales of the collateral would seriously embarrass and probably prevent the formulation and consummation of a plan of reorganization. Both courts below so found. The findings of the district court are in the form of recitals in the order, but are nevertheless in substance and in effect findings of fact.

> The circuit court of appeals approved these findings, and added that without some control over the disposition of the collateral, 'the presentation of a satisfactory plan of reorganization might as well be abandoned.' These concurrent findings of the two courts, as this court has often held, should be accepted as conclusive unless clearly erroneous. *United States* v. *Commercial Credit Co.*, 286 U. S., 63, 67, 76 L. Ed., 978, 980, 52 S. Ct., 467; *Stuart* v. *Hayden*, 169 U. S., 1, 14, 42 L. Ed., 639, 643, 18 S. Ct., 274; *Dun* v. *Lumbermen's Credit Asso.*, 209 U. S., 20, 23, 24, 52 L. Ed., 663, 665, 666, 28 S. Ct., 335, 14 Ann. Cas., 501."

IV

Bondholders' Substantive Rights in the Specific Properties.

The District Court and the Circuit Court of Appeals concurred in holding that as a matter of law the various plans of reorganization offered by the debtor violated the constitutional rights of the bondholders in that they sought to deprive the bondholders of substantive rights in the specific properties without their consent. Both courts based their opinions on the unanimous opinion of this court in *Louisville Joint Stock Land Bank* v. *Radford* 295, U. S., 555, 79 L. Ed., 1593, in which certain retroactive provisions of the Frazier-Lemke Act were declared invalid.

The amendment to the Bankruptcy Act known as Section 77B *is retroactive by its terms.* Sub-section (p) provides:

> "This section shall take effect and be in force from and after the date of the approval of this amendatory Act *and shall apply as fully to debtors, their stockholders and creditors, whose interests or debts have been acquired or incurred prior to such date,* as to debtors, their stockholders and creditors, whose interests or debts are acquired or incurred after such date. Proceedings under this section may be taken in proceedings in bankruptcy which are pending on the effective date of this amendatory Act."

The bonds involved in this controversy, aggregating in principal amount $750,000.00, were issued by Tennessee

Publishing Company on November 1, 1928, and were secured by a contemporaneous deed of trust constituting a first mortgage on the physical assets and properties of the debtor corporation. Section 77B was added to the Bankruptcy Act by the 73d Congress and it became effective June 7, 1934. Prior to the time of the enactment of this amendment the debtor corporation had made various defaults in the payment of interest, sinking fund, and other provisions and conditions under the indenture, and C. O. Carpenter, Receiver of Holston-Union National Bank, of Knoxville, Tennessee, the holder of $28,000.00 in principal amount of said bonds, had filed a bill in the United States District Court for the Middle District of Tennessee, asserting the right of the bondholders to a judicial public sale of the properties because of such defaults, and the court had placed the properties in the possession of a receiver for the purpose of liquidation and sale. All of the other bondholders joined in the proceeding and it was sustained as a general creditors' bill. This occurred more than a year prior to the passage of Section 77B as an amendment to the Bankruptcy Act.

Upon the filing of the debtor's petition and during the course of the various steps taken in the District Court, bondholders owning and holding more than seventy-two per cent of the outstanding issue intervened in the cause and expressly declined to consent to any of the plans of reorganization, asserting, in addition to the practical grounds for rejection hereinbefore set out, that the plans if approved would deprive them of their substantive rights in the specific properties of the debtor acquired prior to the passage of Section 77B as an amendment to the Bankruptcy Act, and would be in violation of the Fifth Amendment to the Constitution of the United States.

While the various plans proposed by debtor baffle complete analysis, we have heretofore undertaken in a previous portion of this brief to state their principal provisions. It is submitted that the following statements can not be disputed in the record:

(1) The bonds are dated and were issued on November 1, 1928, in the principal sum of $750,000.00, and are secured by a registered deed of trust, which, under the laws of Tennessee, constitutes a first lien on the debtor's properties. The principal of the bonds, to-wit, $750,000.00, and interest in the sum of $139,375.00 (as of July 1, 1935), are due and unpaid.

(R., 19-20.)

(2) The debtor is seeking by its plans of reorganization to require the cancellation of the sinking fund provisions contained in the trust indenture and the release of the lien to secure the same, without the consent of any of the bondholders and notwithstanding the affirmative disagreement of more than two-thirds of such bondholders.

(3) The debtor's plans further require the cancellation of all accrued and past due interest ($139,375.00 as of July 1, 1935, plus subsequently accrued interest), and the release and surrender by the bondholders of their lien against the specific properties to secure the payment of such interest, without the consent of any of the bondholders and over the affirmative objection of more than two-thirds thereof.

(4) The debtor seeks also to require the acceptance by the bondholders of the appraised value of the properties covered by the indenture; or, in the alternative,

(5) The debtor demands the scaling down of the principal amount of the bonds either to the appraised value of the bonds based on an appraisal of the properties or to the amount paid by the last purchaser, and a cancellation and surrender of the lien of the indenture against the debtor's properties to the extent of such reduction, without the consent of any of the bondholders and over the affirmative objection of more than two-thirds thereof.

(6) A compulsory revision of the interest rate provided under the indenture (presumably by a reduction) and a surrender and cancellation of the lien against the specific

properties to the extent of such revision, without the consent of any of the bondholders and over the objection of more than two-thirds thereof.

(7) A compulsory extension of the time for the payment of the past due bonds to a future date (apparently a number of years hence) in the reduced principal amount, a different and less rate of interest, with all existing sinking fund provisions eliminated, without the consent of any of the bondholders and over the affirmative objections of more than two-thirds thereof.

It is therefore respectfully insisted that the debtor's proposals take from the bondholders the following substantive rights in the debtor's specific properties:

(1) The right to retain the lien until the indebtedness thereby secured is paid.

(2) The right to realize upon the security by a judicial public sale, or by the Trustees, as provided in said indenture.

(3) The right to determine when such sales shall be held, subject only to the discretion of the court and to the terms and conditions of said indenture.

(4) The right to protect its interest in the property by bidding at such sale whenever held and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of proceeds of a fair competitive sale, or by taking the property itself.

(5) The right to control meanwhile the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt.

The rights above enumerated are those which were stated by this court in the recent case of *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S., 555, 79 L. Ed., 1593.

In the *Radford* case this court unanimously held that certain provisions of the amendment known as Section 75

of the Bankruptcy Act (Frazier-Lemke Act) were violative of the Fifth Amendment to the Federal Constitution insofar as they related to lien debts existing at the time the Act became effective. Section 77B of the Bankruptcy Act is likewise retroactive. (See section (p).) The rights of the bondholders in the present case were acquired in 1928, prior to the passage of Section 77B as an amendment to the Bankruptcy Act. The respondents do not contend that Section 77B of the Bankruptcy Act is invalid or unconstitutional in its general scope and application. The debtor, in the present case, is seeking to force the bondholders to surrender the substantive rights enumerated above, without their consent, and claims the right to do so under the provisions of sub-section (b) (5), Section 77B of the Bankruptcy Act. The debtor insists that under this section of the Act it is not required to obtain the consent of the bondholders, or any part thereof, if its plans provide for an appraisal and payment either in cash of the value either of such interest, claims or liens, or, at the objecting creditors' election, of the securities allotted to such interest, claims or liens under the plan, if any shall be so allotted. The bondholders deny the right of the Congress to *retroactively* grant any such right or rights to the debtor and assert that the section in question, if construed and applied in accordance with the debtor's contention, is unconstitutional and violative of the Fifth Amendment to the Federal Constitution.

In the *Radford* case this court said:

> "The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the states, it is not prohibited from impairing the obligations of contracts. Compare *Mitchell* v. *Clark*, 110 U. S., 633, 643, 4 S. Ct., 170, 312, 28 L. Ed., 279. But the effect of the act here complained of is not the discharge of Radford's personal obligation. It is the taking of substantive rights in specific property acquired by the bank prior to the act. In order to determine whether rights of that nature have been taken, we must ascertain what the mortgagee's rights were be-

fore the passage of the act. We turn, therefore, first to the law of the state."

295 U. S., pp. 589-590, 79 L. Ed., at pp. 1604-5.

It is conceded in the present litigation that the substantive rights of the bondholders are identical with those found by the court in the *Radford* case to exist under the laws of Kentucky. Referring to the Frazier-Lamke Act, the court rendered its decision in the following language:

"Its avowed object is to take from the mortgagee rights in the specific property held as security; and to that end 'to scale down the indebtedness' to the present value of the property. As here applied it has taken from the Bank the following property rights recognized by the law of Kentucky:

"(1) The right to retain the lien until the indebtedness thereby secured is paid.

"(2) The right to realize upon the security by a judicial public sale.

"(3) The right to determine when such sale shall be held, subject only to the discretion of the court.

"(4) The right to protect its interest in the property by bidding at such sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.

"(5) The right to control meanwhile the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt."

295 U. S., pp. 594-595, 79 L. Ed., at p. 1607.

The argument made by debtor to the effect that no right of any value was taken from the lienholder since his interest was limited to the value of the property and that if under a fair appraisal he received the actual value of the property no complaint could be made, was answered by Justice Brandeis in the following language:

"The contention rests upon the unfounded assertion that its only substantive right under the mortgage is to

have the value of the security applied to the satisfaction of the debt. It would be more accurate to say that the only right under the mortgage left to the bank is the right to retain its lien until the mortgagor, sometime within the five-year period, chooses to release it by paying the appraised value of the property."

295 U. S., p. 596, 79 L. Ed., at p. 1608.

The court, in conclusion, said:

"The province of the Court is limited to deciding whether the Frazier-Lemke Act (11 U. S. C. A. § 203 (s)) as applied has taken from the bank without compensation, and given to Radford, rights in specific property which are of substantial value. Compare *Ochoa* v. *Hernandez y Mocales*, 230 U. S., 139, 161, 33 S. Ct., 1033, 57 L. Ed., 1427; *Citizens' Savings & Loan Association* v. *Topeka*, 20 Wall., 655, 662, 22 L. Ed., 455; *In re Dillard*, 7 Fed. Cas., page 706, No. 3,912. As we conclude that the act as applied has done so, we must hold it void; for the Fifth Amendment commands that, however great the nation's need, private property shall not be thus taken even for a wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public."

295 U. S., pp. 601-602, 79 L. Ed., at p. 1611.

After the announcement of the decision of this court in the *Radford* case, Congress amended the Frazier-Lemke Act so as to provide for the cancellation of the lien indebtedness by the payment of the appraised value only in the event the holders of the lien indebtedness consented. If the lien holders declined to accept the appraised value the debtor was left in possession for a maximum period of three years, conditioned upon the payment of a certain rental to the lien holders, with the right to a judicial public sale in favor of the lien holder upon the happening of certain contingencies. The Federal Courts, following the principles announced in

the *Radford* decision, have quite generally held the amended Frazier-Lemke Act unconstitutional insofar as it is retroactive.

In re Lowmon, 79 F. (2d), 687.
In re Young, 12 F. Supp., 30.
In re Sherman, 12 F. Supp., 297.
In re Tschoepe, 13 F. Supp., 371.
In re Schoenleber, 13 F. Supp., 375.
In re Davis, 13 F. Supp., 221.
In re Diller, 13 F. Supp., 249.

The petitioner apparently concedes that it is seeking by its various plans to take from the bondholders the five substantive rights enumerated by this court in the *Radford* case and heretofore set out in this brief, and that it seeks to do so without the consent of any of the bondholders and over the affirmative objection of more than two-thirds thereof. It points to sub-section (b) (5) as authority for its position. We submit that upon this construction and in the light of the undisputed facts of the present case, sub-section (b) (5), if so applied, would be clearly a violation of the Fifth Amendment to the Constitution of the United States.

The *requirements* of the third plan of reorganization, effectively deprive the bondholders of the five substantive rights in the specific properties, just as the previous plans had done. We have summarized the requirements of this last proposed plan in the foregoing pages of this brief at pages 17 to 19, and have shown that it requires the cancellation of accrued interest exceeding $140,000.00, the release of sinking fund provisions, and the perpetual discharge of the bondholders' lien against the specific properties to the extent that it secured this interest and the sinking fund provisions. It requires the bondholders to accept the appraised value of the properties notwithstanding an offer was filed in the cause exceeding the appraised value by a substantial sum, or to consent to a scaling down of the principal to the sum paid for the bonds by the last purchaser irrespective of the amount received by the debtor at the time the bonds were issued. The interest is to be reduced and the maturity of the bonds is to be extended to

some indefinite period in the future and the lien of the indenture modified accordingly.

The entire plan was conditioned upon the denial of a judicial public sale to the bondholders notwithstanding the admitted default. It would deprive the bondholders of their admitted substantive property rights under the laws of Tennessee as stated by Circuit Judge Simons in the opinion of the Circuit Court of Appeals, as follows:

> "Here, under Tennessee law, as there under Kentucky law, the lien holders had the right under their contract to retain the lien until the indebtedness secured was paid, the right to realize upon the security by a judicial public sale, the right to determine when such sale should be held, subject only to the discretion of the court, the right to protect their interest in the property by bidding at such sale, the right to have the mortgaged property devoted primarily to the satisfaction of the debt, and the right to control the property meanwhile during the period of default, subject only to the discretion of the court, and to have the rents and profits during such period applied to the satisfaction of the debt. These rights are substantive property rights, and any invasion of them under the authority of the present statute is as clearly violative of the due process clause of the Fifth Amendment as it was in the Radford case."
>
> (R., 159.)

In discussing a similar plan of reorganization proposed under sub-section (b) (5), sub-division (d), Section 77B of the Bankruptcy Act, Judge Learned Hand, of the Circuit Court of Appeals for the Second Circuit, in the case of *In re Murel Holding Corp.*, 75 F. (2d), 941, at p. 942, said:

> "It is plain that 'adequate protection' must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference, but a creditor who fears the safely of his principal will scarcely be content with that; he wishes to get his money or at least the property. We see no rea-

son to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most indubitable equivalence."

It is therefore respectfully submitted that the District Judge and the Circuit Court of Appeals were eminently justified in reaching the conclusion that the plans of reorganization proposed by the debtor in this cause, insofar as understandable, were violative of the constitutional rights of the bondholders and justified the dismissal of the proceedings.

REPLY TO CERTAIN CONTENTIONS OF PETITIONER.

The petitioner seems to rest certain of its contentions on the present hearing upon the following statement found in its petition, at page 39b:

> "There is no deprivation of property in any real sense when secured creditors are compelled by law, such as Section 77B, to accept, in place of their contract rights against the bankrupt estate, something which the Court finds, under the circumstances, to be the equivalent."

The authority shown for this statement is the decision in *Campbell* v. *Allegheny Corporation*, 75 F. (2d), 954. The latter case was decided on March 2, 1935, prior to the decision of this Court in *Louisville Joint Stock Land Bank* v. *Radford, supra*, and involved a case where the holders of seventy-seven per cent of the bonds affected by the plan had accepted it in writing. The Court approved the constitutionality of the statute upon the theory of a composition consented to by a majority of a class of creditors. The situation in the present case is just the reverse. More than seventy-two per cent of the bondholders have declined to agree to the plan, and more than fifty per cent of the unsecured creditors have likewise disapproved the plan. However, wholly aside from these considerations, this Court disapproved the petitioner's insistence (above quoted) with respect to the substitution of equivalent values, Justice Brandeis pointing out in the *Radford* case that:

> "The contention rests upon the unfounded assertion that its only substantive right under the mortgage is to have the value of the security applied to the satisfaction of the debt."
>
> 295 U. S., at p. 596, 79 L. Ed., at p. 1608.

Apparently the petitioner also is proceeding upon the theory that Congress may authorize the taking of substantive property rights of the bondholders without a violation of the Fifth Amendment to the Federal Constitution if ade-

quate compensation is given therefor. It was insisted in the *Radford* case that the rights of the lien holders in farm property were taken for a public purpose and that this was justified if rights of equivalent value were substituted. This Court, however, in the course of its opinion in the *Radford* case, pointed out:

> "But the Frazier-Lemke Act does not purport to exercise the right of eminent domain; and neither the law of Kentucky nor Radford's mortgages contain any provision conferring upon the mortgagor an option to compel, at any time within five years, a release of the farm upon payment of its appraised value and a right to retain meanwhile possession, upon paying a rental to be fixed by the bankruptcy courts."
>
> *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S., at p. 596, 79 L. Ed., at p. 1608.

Section 77B of the Bankruptcy Act does not purport to exercise the right of eminent domain and it is conceded that under the law of Tennessee and the debtor's indenture the bondholders, because of various defaults, have the right of an immediate public sale and the right to appear and bid the property in and have it devoted primarily to the satisfaction of their debt, either through the receipt of the proceeds of a fair competitive sale or by the taking of the property itself. Certainly it can not be reasonably claimed that Congress could condemn the substantive property rights of bondholders for the benefit of a private corporation engaged in a private commercial enterprise. Property can only be condemned for a public use, and manifestly a private commercial enterprise, such as the publication of a newspaper, is not a public use.

> (Compare *United States* v. *Certain Lands in City of Louisville*, 78 F. (2d), 684.)

It is further insisted that the provisions of sub-section (c) (5) of Section 77B are substantially the same as those contained in sub-section (e) of Section 77 of the Bankruptcy Act which this Court upheld as an act on the general subject of bankruptcy in the case of *Continental Illinois Nat'l. Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S., 648, 79 L. Ed., 1110. Section 77 of the Bankruptcy

Act deals wholly with the reorganization of railroads, which are affected with a public interest, but aside from this consideration it is to be noted that the petitioner, in referring to sub-section (e) of Section 77 of the Bankruptcy Act, has failed to take into consideration the provisions immediately following those quoted by the petitioner, as follows:

> "*Provided*, That, *if the plan has not been so accepted by the creditors* and stockholders, the judge may nevertheless confirm the plan *if he is satisfied and finds, after hearing*, that it makes adequate provision for fair and equitable treatment for the interests or claims of those reejcting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; *and that the plan conforms to the requirements of clauses (1) to (3), inclusive, of the first paragraph of this subsection (e).*"

"The requirements" in clauses (1) to (3) are the provision that the judge can approve the plan only if he is satisfied that:

> "(1) It complies with the provisions of sub-section (b) of this section, is fair and equitable, *affords due recognition to the rights of each class of creditors*, and stockholders, does not discriminate unfairly in favor of any creditors or stockholders, *and will conform to the requirements of the law of the land* regarding the participation of the various classes of creditors and stockholders; . . ."

It appears therefore that the Railroad Reorganization Act places upon the judge the affirmative duty of seeing that the plan does not violate the substantive property rights of any of the creditors as guaranteed by the Fifth Amendment to the Federal Constitution.

There is no contention in this case that Section 77B is not a valid law upon the general subject of bankruptcy, the insistence on the constitutional phase relating only to subsection (b) (5) as sought to be applied by the debtor in this case.

In support of its statement that it was acting in good faith, the debtor urges as evidence thereof that it could not anticipate that the Court would hold sub-section (b) (5) unconstitutional. The argument is that until the Court had actually declared the above provision invalid the debtor had the right to assume it to be valid and that such conclusion does not warrant the imputation of bad faith. The error of the argument lies in the fact that the debtor makes no distinction between honesty of motive and the existence of a reasonable possibility of a successful reorganization. The District Judge and the Circuit Court of Appeals predicated the dismissal of the debtor's proceedings not alone on the violation of the bondholders' substantive rights but also upon the fact that the debtor was so notoriously insolvent and the receivership was so obviously losing money that it would be unwise and improper to longer defer the inevitable sale of the properties which had already been administered under an equity receivership proceeding for more than two years prior to the filing of the debtor's petition. The debtor itself was a party to the equity receivership cause and all of these facts and circumstances were well known to it and certainly were known and fully appreciated by Carmack, who admits that he acquired the common stock of the debtor corporation *on the day before the sale was to be ordered in the equity proceeding.* The contention also overlooks the fact that the *Radford* decision was announced by this Court on May 27, 1935, and was given wide publicity as it invalidated a companion statute of Section 77B. Carmack purchased his interest in the notoriously insolvent corporation after the *Radford* decision and his contention has no merit on the facts of the case assuming it to be of legal consequence.

The insistence of petitioner that the Circuit Court of Appeals was without jurisdiction to pass upon the question of debtor's good faith is without merit. It is true that upon the filing of the debtor's petition on June 6, 1935, an order was entered by the District Judge allowing it to be filed and reciting that it had been filed in good faith. This same order, however, in a subsequent paragraph issued a rule permitting creditors to appear and show cause, if any, whether or not the petition should be dismissed.

(R., 1.)

The effect of the show cause order contained in the same decree was to render the adjudication of good faith a mere *prima facie* statement subject to be rebutted on the show cause order. This was done and the Judge dismissed the entire proceeding at its conclusion on a hearing *in response to the show cause order.* This appears at the beginning of the oral opinion of the District Judge delivered October 15, 1935, the District Judge expressly reciting:

> "Upon the filing of the petition by the debtor corporation to reorganize under Section 77-B, an order was entered approving it as properly filed, and that it was filed in good faith. However, the right was reserved to any person in interest to object to it upon any legal grounds, and parties in interest were directed to show cause why it was not filed in good faith."
> (R., 111.)

The debtor's appeal was from this order dismissing the proceeding in response to the show cause order. It is true that the District Judge was of the opinion that the debtor was acting in good faith in the sense of sincerity or honesty of purpose. It was proper for the Circuit Court of Appeals to review this holding of the District Judge if it involved an erroneous application of principles of law. The Circuit Court of Appeals held that the words "good faith" as used in the statute relate not to honesty of purpose or intent but to a reasonable expectation of successful reorganization, and concluded:

> "If we are right in this, there was erroneous application of the law in the finding of good faith, and the decree dismissing the petition should upon familiar principles governing appeals in equity be affirmed if right, however erroneous may be any given conclusion of law."
> (R., 157.)

It is believed that the sound reasoning of the Circuit Court of Appeals does not require further elaboration.

In several parts of the petitioner's argument it is stated in substance that the validity of the bonds issued by the debtor has been attacked in the equity receivership cause and that this issue is undetermined. For example:

"A petition is pending in the equity cause of *C. O. Carpenter, Receiver,* v. *Tennessee Publishing Company,* filed by unsecured creditors, attacking the validity of the bonds, and also questioning the amount due thereon, if held valid. This proceeding is undetermined."
Petition for *Certiorari,* p. 51b.

This statement is inadvertent and finds no support in the record. On the other hand, the District Judge, in his final opinion, referring to the equity receivership cause, said:

"In that case the validity and amount of the bonds outstanding was established. The debtor was a party to that suit; the question was submitted to the Standing Master and he made his report covering that question. The report, I am informed, is unexcepted to."
(R., 122.)

For the reasons which we have hereinbefore set out, it is believed that the assignments of error made by the petitioner are without merit and that the action of the District Judge and the Circuit Court of Appeals for the Sixth Circuit should be affirmed by this Court.

Respectfully submitted,

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